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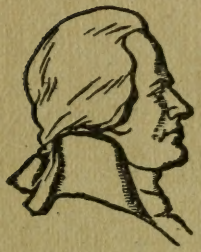
[Modern business talks]

CHOOSING THE FORM OF BUSINESS ORGANIZATION



MODERN BUSINESS
TALK No. 5

ALEXANDER HAMILTON INSTITUTE
NEW YORK

Choosing the Form of Business Organization

Number Five of a Series of Modern Business Talks Prepared by the Alexander Hamilton Institute

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ALEXANDER HAMILTON INSTITUTE
NEW YORK

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READING ASSIGNMENT
NUMBER FIVE

"The three elements or incidents of ownership are income, control and risk."
—Page 6, Chapter I, Volume 3 of the MODERN BUSINESS Text.

(1) Read this Talk on "Choosing the Form of Business Organization." The choice of business organization best suited to the nature of the enterprise—everything considered—is of no small importance to the subsequent success and permanency of the business. This Talk directs attention to some of the things to be considered in that connection.

(2) Read from the beginning to Chapter IX (pages 1 to 125, inclusive) of "Organization and Control," which is Volume 3 of the MODERN BUSINESS Text.

(3) Read with care Lecture No. 3 which accompanies this Talk.

In your reading of the MODERN BUSINESS Course be methodical and do not fall behind. The following is a good plan: Read the Talk as soon as it arrives—it is the work of but a few minutes—then take up the Text assignment, reading with deliberation and concentration. Next read the Lecture when there is one, or solve the Problem. Aim to get all this done within the first week and use the second week for a thoro review of the current assignment and for a rapid review of the preceding month's work. Above all, keep up your enthusiasm!

The real joy of life is the pleasure man gets out of his work.

Choosing the Form of Business Organization

> "*Careful consideration of the legal incidents of the partnership relation will serve to make easy an understanding of the advantages and disadvantages of this form of organization,*"—Page 40, Chapter III, Volume 3 of the MODERN BUSINESS Text.

Andrew Carnegie, whose right to speak on the subject of business organization no one questions, has declared publicly his belief in the partnership as a desirable form of business from the viewpoint of successful management. He considers it in this respect much better than the corporate form. That there is another side to this question, however, appears from the following narrative.

A few years ago there was in a central Ohio town a manufacturing firm consisting of three partners who were doing business under the partnership name of Green, Hedge and Smith. Originally, the firm had been bought by Theodore Green and Walter Smith. That was more than twenty years ago, when the partners were young men. Fully ten years later, Joseph Hedge became connected

with the business as a salesman, and his success in that capacity eventually led to his receiving a financial interest in the business.

Soon after the latter event the course of the business underwent a change. Till then the business had been conducted in a conservative manner with profits regular and with slowly growing output. Now the partners became imbued with a desire to go into large-scale production. They felt that by materially increasing their output they could correspondingly increase their profits.

Increasing Financial Burdens

But a larger output meant, of course, the erection of a larger plant. Additional buildings would be needed. These, in turn, had to be equipped with the necessary machines and tools. The increased volume of business would likewise demand additional office facilities—additional furniture and fixtures and additional help. But having decided to go into the thing, the partners were determined to do it right, even tho it meant a large expenditure of money.

Presently, ground was broken for a large modern factory building. Special, up-to-date machinery was purchased and installed and spacious offices were provided, equipped with the latest office devices.

And now that they were preparing for larger production, the partners realized that their marketing activities also would have to be increased in order to keep the plant working to its full capacity. And if they were to sell more goods, it would be necessary

to make a larger appropriation for advertising than had hitherto been required. The services of a high-priced advertising counsellor were obtained and an active campaign was planned for the next twelve months.

In anticipation of increased production, large quantities of raw material were contracted for and several large auto trucks were purchased to replace the horse-drawn vehicles.

All this taxed severely the financial resources of the partners. The firm's credit had always been good, but the maturing obligations made necessary considerable financial maneuvering—a condition that probably would continue for a number of months and that might even grow much more difficult. The firm was going into debt rapidly, but hoped to weather the storm and to see the business once more upon a paying basis. As Green, the senior partner, upon whom the burden of making the financial arrangement rested, used to say; now that they were in it, they would have to "see the thing thru."

A Sudden Change

Then the unexpected happened. Green died suddenly. He had left the office in the evening, apparently a well man, and in the morning a telephone message from his home brought the tidings of his death.

The news was a shock to the remaining partners. Coming at a time when the financial affairs of the firm were in such a difficult condition, it was almost

a calamity. Who could replace Mr. Green who thruout this expensive enlargement of the business had single-handed conducted all the financial negotiations?

But another surprise was in store for the partners. Green had been believed by everyone—his partners included—to be in very comfortable circumstances. It was found that he had died virtually penniless. Aside from a moderate life insurance, he left nothing for his heirs. Subsequent inquiry revealed the fact that during recent years he had dissipated his wealth—the savings of a lifetime—in frequent speculation.

During the days that followed, the administrator of Green's estate was a frequent visitor at the office of the plant. He demanded an accounting and the formal dissolution of the partnership, and he was insistent. In vain did the remaining partners urge and plead for a continuance of the business undisturbed during this period of reconstruction and until its affairs once more were in a normal condition.

"You will ruin us," they said.

"So much the worse for you," he replied. "But I want the assets of the estate as they are today. I don't know what they will be a year from now and I don't wish to take any chances."

The Sequel

Thus far the creditors of the firm had displayed a commendable willingness to carry the account until the firm's affairs were arranged satisfactorily, but upon learning of the hostile attitude of the deceased

partner's administrator, they decided that for their own protection they must act and act quickly. This they did, with the result that when the business had been liquidated there was found to be a deficit of nearly $18,000.

The creditors now turned their attention to the individual partners who under the law are personally liable to the extent of their private means for the debts of the partnership. Hedge, the junior partner, had nothing aside from his interest in the business, hence nothing could be collected from him. He simply stepped out of the business and resumed his old trade of selling goods on the road.

Smith, however, fared worse. His modest private fortune was completely swallowed up in satisfaction of creditors' claims. Tho well along in years and practically penniless, he was put to the stern necessity of making a fresh start in the world—a task at which, when last heard of, he had not been very successful.

In many existing partnerships no provision has been made for the protection of surviving members or for the continuance of the business upon the death of a partner.

By Way of Contrast

It is interesting to consider what would have happened had the business been in corporate form, instead of a partnership. Green's death would not,

in that case, have involved the breaking up of the business. The administrator of Green's estate would have been unable to demand the liquidation of its affairs. He would have held some certificates of stock as evidence of the rights of the deceased's estate to participate in the profits of the business as a going concern. Had he wished to sell the certificates, he could have done so without even faintly disturbing the business—certainly without disrupting it. Hedge and Smith would be holding the majority of the stock and as such would have continued as officers of the corporation with full power to transact all necessary business. They would not, therefore, have had to suspend operations just when to do so meant ruin. Instead, they could have continued the firm's policy and carried it to a successful issue.

But even if by some chance the business should have been forced to suspend, Smith's private fortune would at least have been spared to him.

Things to be Considered

The foregoing case shows some of the reasons why the corporate form of business is becoming more and more popular. At one time it was decidely unpopular and obstacles were frequently put in the way of those who wished to make use of this form of transacting business.

We are not to suppose, however, that in every case the corporate form is the most advantageous. That depends upon a number of things and cannot be decided offhand. In Chapter I of our assign-

ment, the author discusses the forms and purposes of business organization and touches upon the various factors that should be considered in the selection of a form of organization. This chapter forms an excellent introduction to the more detailed study of individual proprietorships, general partnerships and limited partnerships that follow in Chapters II to IV.

The author also points out that the three factors to be considered in connection with business ownership are: Income, control and risk. That is to say, that form of business is generally best that under the circumstances affords the largest income, that permits the fullest control and that involves the least risk. The consideration of these factors in the chapters mentioned will prove interesting, just as a knowledge of these principles will aid in an intelligent choice of business organization under any given circumstances.

If foresight is necessary after a business has been established, it is at least equally necessary before the business is organized.

The Partnership Relation

Owing to the peculiar nature of the partnership relation, there are a number of things that a partner cannot do. Thus, he cannot sell or transfer his rights as a partner, nor can he pass them on to his heirs. Neither purchaser nor heir, by such transfer becomes a partner, tho he may demand an accounting and obtain payment of the partner's share in the

business after all claims against the partnership have been paid. That is because participation in a partnership is permitted purely on a personal basis. Nor can a partner oppose his own personal interests to those of the firm, since the relationship demands that he devote his attention to the welfare of the partnership. Any breach of good faith in this respect usually brings its own punishment, either thru a judgment of court or—as in the case presently to be related—thru the complication likely to arise in consequence of an illegal association.

A Breach of Faith

When William Carter and Henry Wolff entered into a partnership agreement for the conduct of a clothing business, it was expressly stipulated in the articles of copartnership that neither partner should, during the period of the partnership, enter into any other partnership relation. For several years the business was conducted with varying success, but when, following the outbreak of the European war in 1914, a business depression swept over the country, the clothing business suffered along with other lines of business.

It was at this juncture that Wolff, who had considerable private capital surreptitiously entered into partnership with a Mr. Silverman, who conducted a stationery and notion store in the same city. By reason of this arrangement, Silverman was able to purchase a large supply of goods at prices which

to the new partner appeared very attractive, and on terms of ninety days, payment being by note signed "Silverman and Company."

But the stationery and notion business refused to show a profit, while on the other hand the clothing business, after a few months, took a rapid and decided turn for the better. When month after month the former business showed increasing losses, Mr. Wolff, apparently repenting of his illicit alliance, sought a dissolution of his partnership with Silverman. To this the latter offered no serious objection, and promised, in view of certain concessions, to take care of notes that had been issued by the partnership. But when these notes fell due, Silverman failed to meet the obligation, with the result that Wolff was threatened with suit as a partner in the enterprise. The latter discovered, moreover, that Silverman had issued notes in the firm's name after the partnership had been dissolved, tho he had taken the precaution to antedate the notes so as to bring them within the partnership period.

This act on the part of Silverman was, of course, fraudulent and Wolff could have invoked the aid of the courts for his protection, but to do so would necessarily involve a disclosure of his own bad faith in violating his agreement with Carter. Moreover, from a financial standpoint, a breach with Carter would probably entail greater loss than the payment of Silverman's notes. At any rate, he chose the latter course as the lesser of two evils and pocketed his loss with as good grace as possible. It was a

costly lesson, but one, let us hope, that was well learned.

> *The man who would attain success in business at the sacrifice of honor, usually pays dearly for his short-sightedness.*

Two Kinds of Partnership

The difference between general and limited partnerships is one that should be fully understood, since obligations that attach to the former do not necessarily affect the latter. That is to say, a general partnership entails the unlimited liability of all members. This is not so in a limited partnership, hence ignorance of this difference might involve a loss to a creditor who depended upon the wealth of a certain partner as a guaranty of the payment of his claim when, as a matter of fact, such partner could not be held accountable at all. The author makes plain the difference between these two types of partnership.

Syndicates or Joint Adventures

There is a close resemblance between a partnership and a syndicate, yet in some respects they differ materially. There is a decided difference with regard to the effect of the withdrawal or death of a member, just as the right to bring suit against an associate is wholly different in the two cases. The author in Chapter V describes in detail the

syndicate or joint adventure and touches upon the history of some of the important syndicates that have been formed in the United States.

Trusts and Joint Stock Companies

Much misapprehension exists with regard to the word "trust" as designating a form of business organization. The origin of this term, the legal nature of trusts and many other facts connected with the subject are interestingly presented in Chapter VI. In the following chapter the subject discussed is the joint stock company—really a cross between the partnership and the corporation. This form of organization, tho by no means so common as either of its related forms, possesses certain advantages with which every business man should be acquainted. In certain lines of business, notably in that of the large express companies, this form has been found especially desirable. In common with other forms of organization, the joint stock company has certain drawbacks which should be duly noted. Both the advantages and the disadvantages of this form are set forth in Chapter VII.

> *More than one-half of preparation consists of information. He who is well informed is rarely unprepared.*

Voluntary Associations and Cooperative Societies

The last two chapters in the present assignment are devoted to a discussion of voluntary associations and cooperative societies. Among the former we

find lodges, fraternities, unions, clubs, etc. These are not partnerships, nor are they joint stock companies nor corporations, tho partaking of the character of each. Such associations have certain legal rights and liabilities which should be understood since each member may be held personally liable for debts incurred by the association. When we consider that the stock and produce exchanges with their extensive activities have this form of organization, we realize that it deserves more than superficial examination.

A study of the movement relating to the formation of cooperative societies is interesting inasmuch as this form of organization gives evidence of growing popularity. Both among producers and among consumers such societies have been established and in many states legislation has aided these efforts. The dairy business appears to have some of the most active societies of this kind, tho manufacturing enterprises are also conducted upon this plan. Serious objection has been made to this form of organization, the nature of which is described in Chapter IX. The obvious advantages of cooperative societies are likewise discussed in that chapter.

Conclusion

The current reading assignment is especially important in that it affords a clear insight into the special features characteristic of present-day forms of business organization and thereby makes plain

how control in any given case may most readily be assured to those who assume the largest risks in the undertaking. It prepares, moreover, the way for intelligent study of the corporation which forms the subject of the next assignment. The clear and direct manner in which the Text presents these matters makes the reading both easy and pleasurable.

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Choosing the form of business organization

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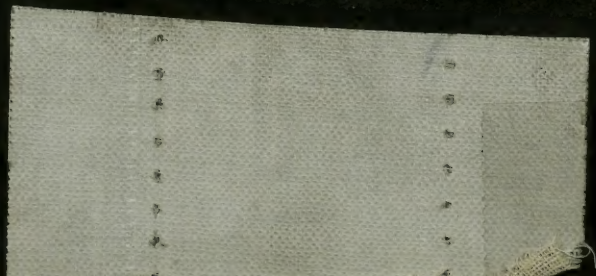

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